Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Ashburn | Analyst: Darrine Distefano | Bill Number: SB 1523

Related Bills: See Prior Analysis | Telephone: 845-6458 | Amended Date: April 12, 2004

Attorney: Patrick Kusiak | Sponsor: ____

SUBJECT: Employer Hiring Credit

X DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced February 19, 2004.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended ____________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 19, 2004 STILL APPLIES.

X OTHER - See comments below.

SUMMARY

This bill would provide a hiring credit to employers with fewer than 19 employees.

SUMMARY OF AMENDMENTS

The April 12, 2004, amendments delete the previous language and add provisions discussed in this analysis. Department staff, as requested by the author's office, provided these amendments. The *Federal/State Law, Legislative History, Fiscal Impact*, and *Other States' Information* discussion from the February 19, 2004, analysis still apply.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. The credit would apply to taxable years beginning on or after January 1, 2005, and before January 1, 2010. However, the provisions of the credit would be operative for employees hired on or after July 1, 2005.

POSITION

Pending.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	5/3/04
____ N	____ OUA	X PENDING		

ANALYSIS

THIS BILL

This bill would allow an employer a credit for wages paid to a qualified new employee for the first five years of employment.

This bill defines the following terms:

- "Qualified wages" is that portion of wages paid or incurred by a qualified employer:
  - To a qualified new employee that is not less than ten ($10) per hour, and
  - That cannot exceed ten ($10) per hour for purposes of the credit.

For example, if a qualified new employee were paid wages of $15 per hour, the qualified employer would only be allowed to take the credit for $10 of the $15.

- "Qualified new employee" is a person:
  - Initially employed by a qualified employer on or after July 1, 2005, and paid a rate of compensation no less than $10 per hour. This does not include a person who was initially employed before July 1, 2005, terminated and then re-employed after July 1, 2005. It does not include a person who was initially employed as a seasonal employee.
  - Whose services are directly related to the trade or business of the qualified employer in the qualified area.
  - Who is either a recipient of unemployment insurance benefits or eligible to receive benefits under the CalWorks Program.
  - That when added to the number of preexisting employees employed by a qualified employer does not exceed 19. A preexisting employee is an individual employed by a qualified employer before July 1, 2005, to perform services in this state.

- "Qualified employer" is a person that satisfies the following criteria:
  - Is engaged in a trade or business within a qualified area. A qualified area is an area within a county with an average unemployment rate of 14% or more during 2000-2003, and is not any of the following areas: an enterprise zone, a manufacturing enhancement area, a targeted tax area, or a local agency military base recovery area.
  - As of July 1, 2005, employs 18 or fewer individuals to perform services in this state.
  - Conducts a trade or business and has a net increase in jobs of one or more employees within the qualified area.
  - A net increase in jobs is determined by subtracting the total number of full time employees employed in this state as of July 1, 2005, from the total number of full time employees employed in this state during the second taxable year ending after July 1, 2005. If there is a net increase in jobs, the credit is limited to wages paid to a qualified employee for the number of jobs that have been increased in the state.
  - The total number of qualified new employees employed in the qualified area equals the sum of both of the following: 1). Total number of hours worked by a qualified employee paid an hourly wage divided by 2,000 paid hours, and 2). Total number of months worked by a qualified employee who are salaried employees divided by 12.
  - If a qualified employer commences business during the taxable year, 2,000 paid hours and 12 would be multiplied by a fraction, the numerator is the number of months of the taxable year the qualified employer was doing business in the qualified area and the denominator is 12.

This bill would require the qualified employer to obtain certification from the Employment Development Department (EDD) for the qualified employee. A copy of this certification must be kept on file and provided to the Franchise Tax Board upon request. If the qualified employer fails to comply with these requirements, the credit would be disallowed for any taxable year.

This bill would require the qualified employer to recapture the amount of credit claimed if a qualified new employee is terminated during the first 270 days. However, the credit would be allowed under any of the following: a qualified new employee who voluntarily leaves; a qualified new employee who becomes disabled and cannot perform the duties of employment; misconduct of the qualified new employee; a reduction in trade or business operations of the qualified employer; or the replacement of a qualified new employee by other qualified new employees so that there is an increase in number of employees and number of hours of employment.

This bill specifies that if there is a change in the form of conducting a trade or business of the qualified employer, the relationship between the qualified employer and qualified new employee would continue as normal if the employee continues to be employed in that trade or business.

This bill would treat an employee of a trade or business that is not incorporated, but under a common control, as employed by a single qualified employer. This provision would prevent an employer from transferring the same employee between similar employers to trigger or increase the credit.

This bill would allow any unused credit to be carried over for eight years until exhausted.

This bill specifies any deduction allowed for wages paid or incurred would be reduced by the amount of any credit allowed.

This bill specifies that this credit would be in lieu of any other credit that the qualified employer may claim for wages paid or incurred to a qualified new employee.

IMPLEMENTATION CONSIDERATIONS

Under “qualified new employee” the bill states that the “service” must be directly related to the trade or business in a qualified area. It is not clear if “service” means employment within the qualified area or only within the trade or business wherever it is located. The language of the bill appears to allow the qualified new employee to work outside of the qualified area even if his or her services are related to the employer’s trade or business. The author may wish to clarify under the definition of “qualified employer” that the qualified new employee must be “employed” directly within the trade or business located within the qualified area.

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

TECHNICAL CONSIDERATIONS

The following amendments are provided to correct technical considerations:

On page 3, line 17 and on page 7, line 29, delete the word “three” and insert “four.”

On page 2, lines 23, 25, 28, 32, 34, and 37, on page 3, lines 1, 3, and 13, on page 6, lines 36 and 38, on page 7 lines 1, 5, 7, 10, 13, 15, and 25, delete the word “person” and insert “individual.”

ECONOMIC IMPACT

Revenue Estimate

It is estimated that revenue losses for the initial three fiscal years impacted by this bill are as follows:

Small Business Targeted Employment Hiring Credit *($ Millions)*			
Fiscal Year	2005/2006	2006/2007	2007/2008
Net Revenue Loss	-5	-20	-30

Revenue Discussion

The revenue impact for this bill would depend on the number of "qualified" employees/employers and the latter's capacity to create and sustain a net growth in full-time employment of "targeted" employees over their base employment as of July 1, 2005. Further, the influx of new businesses looking for favorable labor market conditions in the affected counties would generate new employment opportunities for targeted employees and additional revenue losses.

Based on unemployment data from EDD there were six counties that had unemployment rates greater than 14% during 2000-2003. The total number of unemployed in those affected counties averaged about 129,000 persons compared to an average labor force of 653,000. Research suggests that the majority of persons who are not working receive unemployment benefits and/or CalWorks benefits (i.e., "targeted" employees). The number of "qualified" small businesses in the affected counties most likely to expand their present workforce is assumed to be no more than 11,000. These prospective employers currently employ a labor force of 35,000 at the $10 per hour wage or higher. Taking into account the specific requirements of this bill, it is estimated that 3,300-targeted employees would obtain sustained full-time employment within existing qualified businesses over the life of this credit. Also, an additional 2,000-targeted employees would be hired by new businesses moving into the affected counties over this five-year time period.

The maximum tax credit that can be claimed with respect to each qualified employee for his or her initial full year of employment is equal to $10,000 ($10 per hour x 2000 paid hours x 50% of first year wages). For the initial operative tax year (2005), it is projected that the eligible new jobs will be small because of the specified six-month (July – December 2005) window of opportunity (500 employees X $10,000 = $5 million). In 2006, total new jobs eligible for tax relief is estimated at a maximum yearly total of about 2,100 employees (2,100 X $10,000 = $21 million). In 2007, it is estimated that a total of 1,300 employees would be hired (1,300 X $10,000 = $13 million), plus the 2,100 employees ($21 million/80% = $17 million) would be in their second year of employment for a total of $30 million ($13 million plus $17 million). This bill is estimated to have a cumulative potential impact of creating 5,300 new jobs.

ARGUMENTS/POLICY CONCERNS

This bill would require the taxpayer to reduce any wage deduction by the amount of credit taken. This would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

LEGISLATIVE STAFF CONTACT

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